Before the

Federal Communications Commission

Washington, D.C. 20554

In the Matter of	)	
High-Cost Universal Service Reform	)	WC Docket No. 05-337
Federal-State Joint Board On Universal Service	)	CC Docket No. 96-45

Reply Comments Of

Fred Williamson and Associates, Inc. (FWA)

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I

INTRODUCTION

Fred Williamson and Associates (FWA) submits its Reply Comments with respect to the Joint Board NPRM[1], the Identical Support NPRM[2] and the Reverse Auction NPRM[3]. FWA is a consulting firm that provides services to rural Incumbent Local Exchange Carriers (ILECs) in Kansas, Oklahoma, Michigan and Texas. FWA's clients offer a wide array of communications services to rural customers in addition to the traditional telephone services they provide as ILECs. These include broadband services, video services, mobile services, long distance resale, and Competitive Local Exchange Carrier (CLEC) service. These rural ILECs will be directly affected by decisions made by the Commission regarding universal service reform.

II

SUMMARY OF COMMENTS

A. Reverse Auctions should not apply to rural ILECs.

Rural ILECs (a) are not causing fund growth, (b) are using universal service funding to provide efficient modern facilities that provide basic and advanced services to rural customers, (c) are providing high quality services at reasonable and affordable rates comparable to those offered in urban areas and (d) are accountable for the use of universal service funding through reviews and audits by the National Exchange Carrier Association (NECA), the Universal Service Administrative Company (USAC), State

[1] Federal-State Joint Board on Universal Service, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 08-22, released on January 29, 2008) (Joint Board NPRM)
[2] Federal-State Joint Board on Universal Service, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 08-4, released on January 29, 2008) (Identical Support NPRM)
[3] Federal-State Joint Board on Universal Service, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, FCC 08-5, released on January 29, 2008) (Reverse Auction NPRM)

Commissions and the General Accounting Office (GAO). Specifically reverse auctions are inappropriate for rural ILECs because:

1. No area, such as counties, zip codes, Cellular Market Areas (CMAs), Census Block Groups (CBGs), etc., will match the footprint of CETCs and rural ILECs. As a consequence, no auction process will result in a fair and neutral result if rural ILECs are included in the auction.
2. Small rural ILECs operate on an efficient, integrated basis to serve their entire study area. "Cherry Picking", a likely result of reverse auctions, would result in loss of funding for a portion of their study area and would likely result in the inability to continue operations of the remaining portions of the rural ILEC's study area (because the denser portions of the study area tend to help support the less dense areas).
3. Large carriers can inappropriately manipulate an auction process by submitting a below cost bid for a rural ILEC area and by subsidizing their bid from revenues in more profitable service areas.
4. Debt providers will not provide capital for plant upgrades and improvements unless there is a stable revenue stream over the projected life of the plant. An auction every 5, 7 or 10 years would not give the lender the assurance that facilities could be recovered and likely, as the lenders point out, loans would not be made. Shortening the life expectancy of the investment would be the only way to guarantee debt providers the ability to recover their loan. This would result in an unintended increase to the USF to support the faster depreciation of the assets.
5. It is doubtful that specific, detailed rules will be developed and the result will be a flawed auction process.

6. No bidder other than the rural ILEC has facilities to serve all customers in the area. If the ILEC loses the bid, the winner will not be able to serve all customers initially and likely for some time.

B. An overall cap on rural ILEC funding is unnecessary.

Because of the caps on the various rural ILEC funds, rural ILECs are not contributing to the explosive growth of the fund that is causing universal service funding to be unsustainable**.** Most rural ILECs are subject to rate of return regulation. An overall cap on their funding is at odds with this form of regulation because it would simply redistribute rural ILEC support to large ILECs and CETCs and would guarantee that rural ILECs would be unable to earn the authorized interstate rate of return. The Commission should reject a further cap on rural ILEC universal service funding and in particular, should reject an overall cap that would include rural ILEC funding under the same cap with large ILECs and CETCs. In fact, the cap as it is applied today on the High Cost Loop Fund (HCLF) should be removed to provide for the predictable and sustainable funding as required by the Act.

C. Accountability requires that the need for funding be based on carrier's actual costs to provide service.

Actual book costs should be retained to determine funding for rural ILECs. Use of these costs accurately reflects the changing mix of technologies deployed by a rural ILEC as it upgrades its facilities to provide basic and advanced services to customers. In order to prevent waste, fraud and abuse by carriers seeking funding, there must be some means to determine if a carrier needs funding, how much funding is required, and a way for regulators to review the basis for funding and if necessary, audit the basis for and use of the funding. Actual cost based rate of return regulation encourages socially beneficial behavior largely because the carriers under this form of regulation are accountable for the costs they incur and their actions to regulators and customers. It also incents these carriers to reinvest in their networks to maintain the high quality and reliability that customers deserve and that many state commissions require.

Wireless ETCs should be required, either (a) as proposed in the Identical Support NPRM to show their need for universal service funding by providing their actual book costs or (b) if the Commission adopts the Joint Board mobility grant proposal, the actual (projected) costs of facilities to provide the mobility or broadband universal services in the grant area should be provided by the applicant in order to allow the Commissions to determine the financial and technical viability of the proposal and to track its implementation. This provides for the accountability that the customers and Congress expect.

D. The Joint Board recommendation for separate POLR, Broadband and Mobility funds should be adopted with modifications.

Separate Provider of Last Resort (POLR), Broadband and Mobility funds will advance the public interest by allowing the Commission to focus on each fund and its goals individually.

1. Rural ILEC POLR Fund – *First*, embedded costs as the basis for funding should be retained for rural ILECs. *Second*, rural ILEC funds should not be capped. The Commission should lift the HCLF cap. Lifting the cap would provide rural ILECs with greater incentives and the ability to continue to upgrade their facilities so that their customers can have access to broadband services comparable to those offered in

urban areas. However, if the Commission decides not to lift the cap entirely, at the very least it should re-base the cap. *Third,* reverse auctions should be rejected for rural ILECs. Reverse auctions are unworkable for rural ILECs and completely at odds with rural ILEC cost based rate of return regulation. *Finally*, rural ILEC and non-rural ILEC funding should not be combined under one mechanism.

2. <u>Broadband Fund</u> – The modifications to the Joint Board recommendation proposed by AT&T are appropriate. In rural ILEC areas where universal service funding for the network and access charge revenues are allowing the rural ILEC to provide networks capable of providing voice and advanced services, the rural ILEC should be designated as the broadband carrier in order to insure that wasteful duplicative funding is not provided to another carrier. Additionally, the proposed voice service capabilities for the broadband fund should meet those now required by the Commission and should not be streamlined as proposed by AT&T.

3. <u>Mobility Fund</u> - The modifications to the Joint Board recommendation proposed by AT&T are appropriate, except that mobility funding for smaller regional CMRS ETCs should be based on their ongoing actual or embedded costs. These carriers serve primarily rural areas within a state and if the only funding they receive is for the initial construction costs, they do not have the urban customer base that will allow them to use internal funding to maintain and upgrade facilities deployed in high cost to serve areas. Additionally, the proposed voice service capabilities for the mobility fund should meet those now required by the Commission and should not be streamlined as proposed by AT&T.

4. The Sprint Nextel plan should be rejected in its entirety by the Commission. The plan does nothing about (a) identical support, (b) showing a cost based need for funding, (c) receipt of support for multiple wireless handsets or (d) promoting broadband or mobility deployment in rural areas.

E. The identical support rule must be eliminated if fund growth is to be brought under control.

The identical support rule wrongly and at odds with competitive and technological neutrality, treats CETCs as if their cost structures were identical to the ILECs and ignores the material differences between wireline and wireless technologies. Competitive and technological neutrality can only be achieved when differing types of ETCs are subject to identical rules that require each ETC to demonstrate a cost based need for funding. Based on well supported rationale, the Commission concluded that the identical support rule should be eliminated and CETCs seeking funding would need to show a need for funding based on actual book costs. The identical support rule must be eliminated and replaced by a cost based system (either as proposed in the Identical Support NPRM, or under a grant based system for mobility and broadband as proposed in the Joint Board NPRM) that encourages CETCs to provide service in high cost, low density areas and that requires CETCs to demonstrate a need for funding.

F. Access Restructure Is Essential In Conjunction With Universal Service Reform.

In order to preserve revenues essential to maintaining and expanding basic and advanced services, the Commission should:

1. Require that all carriers and providers that use the ILEC networks (including VoIP providers and facilities based broadband internet access providers) pay applicable access charges.
2. Adopt phantom traffic requirements proposed by NECA so that ILECs can determine which carrier or provider should be billed access for the use of the ILEC's network.
3. Reduce intrastate access charges to interstate levels. If the Commission believes that this is too large a change, then it should preserve intercarrier revenues that are required by rural ILECs by adopting a plan that insures that the intrastate access rates and structure mirror the interstate access rates and structure for rural rate of return ILECs.
4. To offset the revenue losses from these access rate and structure changes on a revenue neutral basis, the Commission should implement the Missoula Plan subscriber line charge rate changes and the Plan's Restructure Mechanism or some combination of SLC increases and a Restructure Mechanism on a revenue neutral basis.
5. Implement a federal benchmark mechanism.

G. Additional Necessary Universal Service Reforms.

The following universal service reforms are essential with or without comprehensive universal service reform:

1. The basis of contribution must be revised from interstate retail revenues to a broader and more sustainable base such as working telephone numbers and connections.
2. The parent trap rule should be eliminated because it is harming service to rural Americans by limiting deployment of upgraded networks capable of deploying basic and advanced services. If the Commission does not eliminate the rule, it should

modify it to provide, at a minimum, the same overall dollars that the seller was receiving from the sold exchanges prior to the sale. Alternatively, the Commission could increase substantially the portion of funds provided by the safety valve rule by eliminating the 50 percent limitation.

III

REVERSE AUCTIONS ARE NOT APPROPRIATE FOR RURAL ILECs

A few commenters[4] continue to promote the use of reverse auctions as a method to reduce funding levels. These commenters incorrectly assert that reverse auctions will:

- Provide an efficient level of support and encourage competition and broadband deployment.[5]
- Allow market signals, not cost to determine support. Rationalize and stabilize the fund. Fairly eliminate support and determine the minimum support necessary.[6]
- Award support to the most efficient provider.[7]
- Eliminate the need to determine costs.[8]

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[4] SouthernLINC Wireless (SouthernLINC) proposes an alternative clock-proxy methodology, T-Mobile USA (T-Mobile), Verizon and Verizon Wireless (Verizon), Comcast Corporation (Comcast), TracFone Wireless (TracFone), National Cable and Telecommunications Association (NCTA), NTCH. The District of Columbia, states of Delaware and New Jersey, and the Commonwealths of Virginia and Pennsylvania (MACRUC) indicate in their comments (page 2) that reverse auctions warrant serious consideration and that the fund must be reduced, otherwise net contributor states who already pay more than their fair share will be further burdened (page 3). MACRUC's support for reverse auctions seems to derive from their concern about being contributor states for the high cost fund. However, as the Wyoming Office of Consumer Advocate (Wyoming) points out on page 6 of its Joint Board comments, when the totality of universal service funding (including Schools and Libraries) is considered, high cost fund contributor states may become recipient states. As Wyoming indicates, the decision to adopt or reject any particular proposal (like reverse auctions) should not be based on the contributor/recipient debate, but based on the merits of the proposal. Wyoming, because of a number of concerns, believes that the time is not right to implement reverse auctions (Wyoming reverse auction comments, page 2).

[5] T-Mobile comments at page 2.

[6] Verizon comments at pages 18 and 21.

[7] TracFone comments at page 4.

[8] NCTA comments at page 15.

Reverse auctions, if applied to rural ILECs and their service areas, will not provide these benefits and would instead harm customers and be at odds with the Act's[9] provisions. The proposed use of reverse auctions for the determination of universal service funding relies on an untested and unproven theory that has not been thought through. This theory is replete with problems that render it unworkable for the determination of funding levels in rural ILEC areas. A few of these problems are:

A. Selection of a bidding area that is competitively neutral and fair to all potential bidders is not possible.

SouthernLINC Wireless (SouthernLINC) objects to the use of the ILECs study area and states that "Neutral service areas allow fair competition…it would be unreasonable to expect a new entrant to build beyond its existing footprint to match the entire service area of the incumbent."[10] As an alternative, SouthernLINC proposes the use of counties.[11] Unfortunately, the rural ILEC service area rarely matches county boundaries (See Attachment 1) and thus counties would not be a fair or neutral bidding area for rural ILECs. NTCH proposes the use of CMA's.[12] This may well match the service area of some wireless carriers, but again, this bidding area would not match the rural ILEC's service area (See Attachment 2) and thus could not provide a fair and neutral auction process.

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9 1934 Communications Act as amended by the 1996 Act.
10 SouthernLINC comments at page 25.
11 Id., The Rural Cellular Association and the Alliance of Rural CMRS Carriers (RCA-ARC), although opposing reverse auctions, also suggested counties in its comments at page vi, if the Commission implements reverse auctions.
12 NTCH comments at page 19 and 20.

In a vain effort to propose a workable bidding area that would be covered by all potential bidders, a number of commenters[13] proposed small areas such as CBGs. However, again, the service footprint of rural ILECs does not match the CBG areas (see Attachment 3) and therefore CBGs are unusable as a fair and neutral bidding area.

As Time Warner Telecom (Time Warner) points out in its comments, before considering reverse auctions, one of the problems that must be resolved is the bidding area. Time Warner notes that competitors may only serve a subset of the area selected, making bidding infeasible.[14] RCA and ARC correctly point out that bids must be submitted for identical areas.[15] As demonstrated above however, no area, such as counties, zip codes, CMAs, CBGs, etc., will match the footprint of CETCs and rural ILECs. As a consequence, no auction process will result in a fair and neutral result.

B. If a neutral bidding area could be established (and it cannot), loss of an auction for part of its service area would likely destroy the rural ILEC's business and render it unable to provide quality service at reasonable and affordable rate levels in its remaining areas.

Small rural ILECs operate on an efficient, integrated basis to serve their entire study area. Loss of funding for a portion of their study area (in particular if it is a denser portion of the study area) would likely result in the inability to continue operation of the remaining portions of the rural ILECs study area. Customers in the remaining areas would at best

[13] Comcast comments at page 9. At page 9, Comcast also notes that use of the ILEC wire center as the bidding area tilts the auction in favor of the ILEC because the CMRS licensed service area often doesn't match the ILECs area; TracFone at page 6. At page 5 TracFone also observes that use of any carrier's service area gives an advantage to that carrier in the auction. At page 6, TracFone comments that the bidding area should neither favor nor disfavor any provider or technology; At page 16, NCTA comments that CBGs would be competitively and technologically neutral while using any carrier's area gives that carrier an advantage in the auction because other possible bidders may not match the carrier's footprint.

[14] Comments of Time Warner at page 16.

[15] RCA-ARC comments at page 75.

be harmed by possible rate increases, lower service quality and the rural ILEC's inability to adequately maintain and upgrade facilities and services. At worst, the customers would be without service if the rural ILEC were forced out of business. Even wireless customers would be harmed because many wireless companies rely upon the ILEC for provisioning of transport for their cell sites.

C. Large carriers can inappropriately manipulate an auction process by submitting a below cost bid for a rural ILEC area and by subsidizing their bid from revenues in more profitable service areas.

In its comments, Cellular South states that "Competitive ETCs might also submit artificially low bids if they are willing to use profits in low-cost areas to offset their losses in high-cost areas."[16] The Rural Independent Competitive Alliance (RICA) expresses a similar concern in its comments "…competitive bidding for USF support will give the large ILECs the power to destroy any small company they happen to think is in their way…"[17] This very real concern would be impossible to police in an auction. Rural ILECs could always be under bid by a larger carrier that is willing to subsidize its bid. Rural ILECs would be unable to match the subsidized, artificially low and below cost bid and would unfairly lose the auction.

D. Debt providers will not provide capital for plant upgrades and improvements unless there is a stable revenue stream over the projected life of the plant.

As CoBank, ACB (CoBank) indicates in its comments: "Access to debt capital could be significantly reduced under a reverse auction system….The greater the level of uncertainty about future cash flow, the lower the amount of debt capital available to a

[16] Comments of Cellular South at page 4.
[17] RICA comments at page vii.

borrower."[18] The Rural Telephone Finance Cooperative (RTFC) makes similar observations: "As a lender that is closely engaged with the rural local exchange carrier (RLEC) industry, we can say unequivocally that imposition of reverse auctions on RLECs would significantly impair their ability to borrow funds for capital investment."[19] RTFC also notes that: "The possibility of relatively sudden and possibly total loss of high-cost universal service support at some point in the life of the loan creates an insurmountable level of uncertainty that the borrower will be able to service its debt….Lenders will not lend on that basis."[20]

The depreciable lives of telecommunication facilities are relatively long – up to and sometimes over 20 years. An auction every 5, 7 or 10 years would not give the lender the assurance that facilities could be recovered and likely, as the lenders point out, loans would not be made. The loss of a bid by a rural ILEC in the middle of a 15 year loan would almost certainly result in the ILECs inability to repay the loans it already has with such entities as CoBank, RTFC or the Rural Utilities Service (RUS). The loser is not just the rural ILEC, but customers in rural America that would not benefit from upgraded facilities and services comparable to those offered in urban areas and the banking industry when loans are not repaid (possibly also the Federal government that may be required to bailout the lending institutions).

[18] CoBank comments at page 4.
[19] RTFC comments at page 1.
[20] Id., pages 3,4 and 5.

E. It is unlikely that appropriate requirements could be established for an auction. Even if they are, resources do not exist to monitor and enforce the requirements.

Commenters discussing reverse auctions frequently use terms like "properly structured" and "properly designed"[21] to claim that reverse auctions are workable. However, as a number of commenters note:

- Flawed auction rules can determine winners and losers.[22]
- There is a need to answer what services, what area, what terms and conditions, what price. The Commission must specify minimum quality of service requirements and minimum data speeds, etc.[23]
- Auctions are administratively complex with significant institutional and regulatory processes that must be resolved before conducting auctions - the auction area, quality of service, POLR obligations, etc.[24]
- Auctions are not practical. There are difficult questions that must be answered that will take a substantial amount of time to resolve. Reform cannot wait until these complexities are resolved.[25]
- Auctions are not workable. "There is a far greater likelihood of harm to rural consumers than there is benefit…."[26]
- Auctions require a precise specification of goods and services, negotiation of a detailed contract and supervision and inspection.[27]

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[21] T-Mobile comments at page 11; Comcast comments at page 7; NCTA comments at page 15; Alltel Communications (Alltel) comments at page 7.
[22] ComCast comments at page 8.
[23] General Communications (GCI) comments at pages 26, 28 and 29.
[24] Time Warner comments at pages 15 and 16.
[25] Sprint Nextel Corporation (Sprint Nextel) comments at pages 12 and 13.
[26] Cellular South comments at pages 3 and 4.
[27] RICA comments at page 21.

It is doubtful that specific, detailed rules will be developed and the result will be a flawed auction process. Recent experience with the development of Eligible Telecommunications Carrier (ETC) requirements that were developed piecemeal, and still don't specify an affordable rate level, shows that it is unlikely that specific and precise auctions rules can be developed.[28] In fact, comments by SouthernLINC wireless illustrate the problem with setting standards. SouthernLINC states that it is unnecessary to adopt additional ETC standards for equal access, the capacity to remain functional in emergencies, customer protection, build out, a five year development plan, local calling and financial qualifications.[29] At odds with SouthernLINC's comments, these are some of the very requirements that would be essential to picking an auction winner. However, even if specific rules are developed, it is unlikely that they can be enforced. As RICA notes, the Commissions likely do not have the resources to oversee the contracts.[30] Unfortunately the loser will be the consumer in rural areas. TracFone indicates in its comments that if a provider makes a low bid and subsequently provides poor quality of service that the Commission can asses a monetary penalty. TracFone observes that if the problem persists, the Commission can revoke the carrier's ETC status and re-auction the service area.[31] This sounds straight forward, but the loser in the meantime is the consumer that has poor service quality and possibly no provider pending a re-auction.

[28] The California Public Utilities Commission and the People of the State of California in their comments on the Reverse Auction NPRM at page 4 state that "…the auction process conserves resources and saves time…" The Connecticut Department pf Public Utility Control makes similar comments at page 6 of its comments where it says that implementation of reverse auctions would be simple. At odds with these comments, reverse auctions will not be simple to implement, nor will they save time or resources. Substantial time and resources will be necessary to develop, if it possible at all, bidding requirements, and to monitor and enforce the requirements. Additionally, it is quite likely that protracted litigation will occur regarding stranded costs of losing bidders.

[29] SouthernLINC comments at pages 31 to 33.

[30] RICA comments at page 21.

[31] TracFone comments at page 6.

F. No bidder other than the rural ILEC has facilities to serve all customers in the area. If the ILEC loses the bid, the winner will not be able to serve all customers initially and likely for some time.

If an auction is performed in a rural ILECs area, and if the rural ILEC loses the auction because of poor auction specifications and/or because of below cost cross subsidized bidding by a large carrier, etc., it is likely that the rural carrier will be forced out of business. It will no longer have the revenues to service its debt and will have little choice but to exit the market. Without the use of the losing rural ILEC's facilities, that are now stranded, the winning carrier will be unable to provide service to all customers in the area. As noted by the Oklahoma Corporation Commission, "If an incumbent LEC loses USF support as a result of a reverse auction, it is probable that the incumbent LEC would suffer economic hardship, stop operations or go bankrupt. In either case, rural customers could be denied access to the most basic telecommunications services because most competitive ETCs, including wireless ETCs rely on the incumbent network for, at a minimum, some amount of transport."[32] It is unclear how this rather significant problem will be handled by the Commission. First, how will the losing rate of return ILEC be compensated for its stranded costs? Second, will the Commission require the losing rural ILEC to provide its facilities to the winning bidder in order to continue to provide

[32] Oklahoma Corporation Commission Comments at page 15. The National Association of State Utility Consumer Advocates (NASUCA) in its reverse auction comments at page 2, makes a similar observation "It is unreasonable to think that the FCC can orchestrate the auction of existing high-cost rural territories currently served by incumbents who have invested billions of dollars to provide quality services to their customers, and have carrier of last resort ('COLR')…responsibilities in those areas, without causing irreparable harm to the rural customers who were promised universal availability of quality communications services at affordable and reasonably comparable rates by the 1996 Telecommunications Act."

ubiquitous service in the auction area? At odds with Verizon's "market based approach", auctions appear to be the ultimate in regulatory intervention.[33]

For all of the above reasons, the Commission should not apply reverse auctions to rural ILECs. Rural ILECs (a) are not causing fund growth, (b) are using universal service funding to provide efficient modern facilities that provide basic and advanced services to rural customers, (c) are providing high quality services at reasonable and affordable rates comparable to those offered in urban areas and (d) are accountable for the use of universal service funding through reviews and audits by NECA, USAC, State Commissions and the GAO. As the Oregon Commission observes in their comments, "…we do not agree with the implication in the *Reverse Auction NPRM* that a reverse auction is a good way to allocate funds for wireline voice services."[34] In a similar vein, the North Dakota Public Service Commission "…strongly opposes the imposition of reverse auctions with regard to traditional ILEC ETCs. There are far too many uncertainties…"[35] "…reverse auctions, as proposed, may have unintended and irreversible consequences that will negatively impact rural consumers and may actually deprive rural consumers of telecommunications services. The OCC strongly opposes any reverse auction mechanism that could result in the loss of USF support for incumbent LECs."[36]

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[33] Id., The Oklahoma Commission recognizes the likely need for increased regulatory intervention as a result of uneconomic bidding by large carriers: "Perhaps the incumbent LEC might be required, by rule or economic circumstance, to sell its unprofitable network to the winning ETC bidder so that rural customers could continue to receive telecommunications service. In this case, the Verizon proposal becomes a tool for the forced acquisition of small telephone companies by very large telephone companies who have the economic power to underbid the realistic and necessary support level for a particular rural area."

[34] Comments of the Public Utility Commission of Oregon at page 2.

[35] Comments if the North Dakota Public Service Commission at page 4.

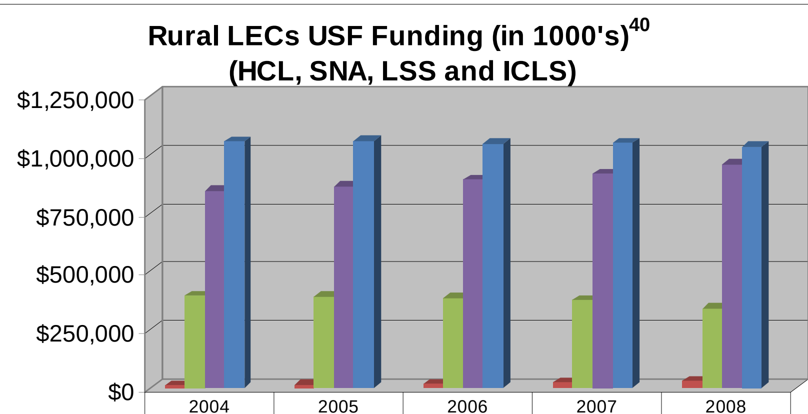
[36] Oklahoma Corporation Commission comments at page 13.

IV

AN OVERALL CAP ON RURAL ILEC FUNDING IS UNNECESSARY AND IS HARMFUL. A CAP IS AT ODDS WITH RURAL ILEC RATE OF RETURN REGULATION

Comcast observes in its comments that all universal service funding, including the funding provided to rural ILECs should be capped at or below the 2007 payment level.[37] NCTA also recommend a cap on total funding and a per-line cap for all providers.[38] This proposal and the recommendation by the Joint Board to impose an overall cap[39], which would include rural ILECs, is unnecessary and inappropriate for rural ILECs. The following Tables factually demonstrate that rural ILEC funding is not contributing to the explosive growth of the Universal Service fund.

Table A



	2004	2005	2006	2007	2008
Safety Net Additive (SNA)	$9,554	$12,655	$16,086	$23,742	$30,662
Local Switching Support (LSS)	$395,798	$390,190	$384,093	$374,831	$340,683
Interstate Common Line (ICLS)	$846,636	$864,586	$892,531	$918,868	$959,289
High Cost Loop (HCL)	$1,055,400	$1,059,821	$1,047,151	$1,050,425	$1,033,666
Total	$2,307,388	$2,327,252	$2,339,861	$2,367,866	$2,364,300

[37] Comcast comments at pages 3 and 11.
[38] NCTA comments at page ii.
[39] Joint Board NPRM, Appendix A, paragraph 26.
[40] Source: USF projections from USAC's USF Appendix HC01 Note: 2004 ICLS amount includes Long Term Support. LTS was fully phased out in 2005. The USF High Cost Loop cap for rural ILECs is

As demonstrated by Table A, rural ILEC funding is largely capped.[41] Because of the caps on the various rural ILEC funds, rural ILECs are not contributing to the explosive growth of the fund that is causing universal service funding to be unsustainable**.** Further, as the Western Telecommunications Alliance indicates in its comments, an overall cap "…guarantees that the rural ILECs will be subjected to substantial and virtually automatic reductions in their high-cost support…" because under an overall cap, rural ILEC cost based funding would be transferred to non-rural ILECs, wireless and broadband providers.[42]

Because rural ILECs are not the cause of fund growth, it is unnecessary and would be harmful to customers[43] to impose an overall cap on rural ILEC cost based funding. In particular, most rural ILECs are subject to rate of return regulation. An overall cap on their funding is at odds with this form of regulation because it would guarantee that these carriers would be unable to earn the authorized interstate rate of return (See Attachment 4 for a brief description of rate of return regulation). As a consequence, the Commission should reject a further cap on rural ILEC universal service funding and in particular,

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determined based on line growth and inflation (47 C.F.R § 36.603and 36.604).The USF Safety Valve Support (SVS) is capped at five percent of the Rural ILEC USF High Cost Loop Fund. (47 C.F.R. §54.305*): "The sum of the safety valve loop cost expense adjustment for all eligible study areas operated by rural telephone companies shall not exceed five (5) percent of the total rural incumbent local exchange carrier portion of the annual nationwide loop cost expense adjustment calculated pursuant to 36.603 of this chapter."*

The rural ILEC LSS and ICLS essentially offset each other. The decline in LSS may be a function of replacement of circuit switches with newer technology switches that are more efficient and less costly. This efficiency is difficult to achieve in loop distribution because even though newer technology (fiber) may be used, the predominate costs are placement costs which are not declining.

[41] As shown in Table A, many of the rural ILEC funds are capped and those that are not capped, are not causing the explosive fund growth.

[42] WTA comments at page 28.

[43] See the comments of the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO) at pages 23 to 28. OPASTCO correctly indicates that the existing rural ILEC funding caps and further caps would (a) jeopardize continued construction and upgrading of broadband capable facilities, (b) threaten the quality of voice grade services, (c) place upward pressure on end user charges and (d) make it difficult to secure financing.

should reject an overall cap that would include rural ILEC funding under the same cap with large ILECs and CETCs. A permanent cap is directly at odds with the provision of Section 254 of the Act that requires that funding be predictable and sufficient. A permanent cap violates the provision of sufficiency and does not guarantee predictability.

V

ACCOUNTABILITY REQUIRES THAT THE NEED FOR FUNDING BE BASED ON A CARRIERS ACTUAL COST TO PROVIDE SERVICE. ACTUAL COSTS PROMOTE ACCOUNTABILITY, THE DEPLOYMENT OF NEW TECHNOLOGIES AND THE UNIVERSAL SERVICE GOALS OF THE ACT

In the Identical Support NPRM, the Commission proposed to replace identical support for CETCs with a cost based showing of need for funding.[44] Even if the Commission adopts a grant based program and competitive bidding for the mobility and broadband funds as recommended by the Joint Board, a cost based showing of need should be required in the grant application in order for the Commission or state commission to evaluate the ability of the applicant to fulfill the grant's universal service requirements.

In reaction to these Commission tentative conclusions, a few commenters that support the continuation of identical support or the adoption of reverse auctions, and oppose the use of actual booked costs to show a need for funding, trotted out tired, discredited and incorrect assertions regarding the use of actual book costs in their comments. Samplings of these tired and incorrect assertions are that actual book costs:

[44] Identical Support NPRM, paragraph 1.

- Are discredited, highly regulatory, complicated, not an exact science, do nothing to more accurately target support and don't answer how much the Commission should pay for universal service.[45]
- Are costly, administratively complex, provide perverse incentives to increase costs and there is no penalty for inefficiency.[46]
- Provide little incentive for efficiency, are complex and difficult to administer and enforce, and produce a paperwork burden.[47]
- Are burdensome and unworkable.[48]
- Have arbitrary cost allocations and are administratively burdensome.[49]
- Continue inefficient, cost plus operations and there is no incentive to streamline operations or improve efficiency.[50]

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[45] Verizon comments at pages 35 and 36. RCA-ARC makes similar incorrect, baseless assertions on pages iv, vii, 5, 13, 22, 30, 31, 51, 52 and 55 of its comments. On these pages, RCA-ARC wrongly claims that developing CETC costs is micro-management and that CETCs would be unfairly disadvantaged by unrealistic, unwarranted obligations that are burdensome, complicated and unwarranted. Further RCA-ARC incorrectly asserts that embedded costs are replete with problems and the Commission should look at embedded costs for cost inflation incentives. RCA-ARC goes on to incorrectly claim that costs reward inefficiencies by entrenched incumbents and that ILEC inefficiencies are a significant source of upward pressure on the fund (from 2000 – 2007, ILEC lines decreased by26% while funding increased by 39.5%). RCA-ARC wrongly asserts that embedded costs are profoundly flawed, a staggering backward step that might cause CETCs to restate their books. Based on these incorrect claims and assertions, RCA-ARC proposes that the Commission, (a) fix the interim embedded cost methods that promote inefficiencies, (b) establish effective measures to prevent waste, fraud and abuse, (c) change the rule for rural ILECs that compares revenue requirements to a benchmark, and (d) reduce support for ILECs that earn supra competitive rates of return.
In its comments, RCA-ARC is attempting to convince the Commission to retain the identical support rule and to not impose actual costs on CETCs. RCA-ARC's unsubstantiated assertions and claims (listed above) are simply an attempt to misdirect the Commission to look elsewhere (i.e. at the rural ILEC costs) in the hope that the Commission will not make the changes proposed in the Identical Support NPRM or the Joint Board NPRM. As discussed in this filing, embedded costs are (a) efficient, (b) promote the introduction of new technologies and services, and (c) provide for accountability to prevent waste, fraud and abuse. In addition, as RCA-ARC should know, the ILEC growth in the fund from 2000 – 2007 was primarily due to a Commission proceeding that reduced access rate levels and transferred those cost based revenues to the universal service fund.
[46] Comcast comments at pages 4 and 5.
[47] GCI comments at pages 64, 65 and 70.
[48] Sprint Nextel comments at page 9.
[49] NCTA comments at page 12.
[50] Cellular South comments at pages 9 and 12.

- Encourages gold plating, discourages innovation and cost cutting, and favors outmoded technologies.[51]

These assertions are clearly and demonstrably wrong. The long experience with the use of actual book costs by rural ILECs to show a need for universal service funding in their service areas shows that:

<u>A. Actual booked costs are the only accurate means to determine the need for universal service funding.</u>

Use of actual book costs accurately reflects the changing mix of technologies deployed by a rural ILEC as it efficiently upgrades its facilities to provide basic and advanced services to customers.[52] SouthernLINK states in its comments that "The rules for distributing universal service support should be identical for all ETCs without regard to the type of technology they use or the type of competition (e.g. incumbent or competitor) they are."[53] SouthernLINK is absolutely correct. Wireless ETCs should be required, either as proposed in the Identical Support NPRM or under the grant program proposed by the Joint Board[54], to show their need for universal service funding by providing their actual book costs, or projected actual costs under a grant application.

[51] NTCH comments at pages 14 and 15.
[52] NTHC at pages 1 to 3 and 17 of its comments argues that ILECs should be weaned from support after seven years because their costs have long been incurred and fully amortized. Apparently NTCH doesn't understand that rural ILECs, in order to provide modern technologies capable of providing quality universal services, are continually and efficiently upgrading their network facilities. As a consequence, it is unlikely that network facilities of any rural ILEC are completely depreciated. Time Warner makes a similar incorrect assertion on page 8 of its comments.
[53] SouthernLINK comments at page 15. RCA-ARC makes a similar observation on page 40 of its comments where it states "All providers of the supported services must be treated equally." Alltel makes similar observations at page 9 of its comments.
[54] Joint Board NPRM, Appendix A, paragraphs 16 to 18.

B. If a carrier seeks to be an ETC and asks for universal service funding, there must be accountability to the public that in the end pays for that funding.

The use of actual book costs do require some work and are more complex than doing nothing (as is the case with identical support) to prove a need for funding. However, in order to prevent waste, fraud and abuse by carriers seeking funding, there must be some means to determine if a carrier needs funding, how much funding is required, and a way for regulators to review the basis for funding and if necessary, audit the basis for and use of the funding.[55] Proof of a need for funding and accountability for the use of the funding requires regulation and some complexity. This is not a burden but a responsibility to the public that provides that funding.

If the Commission adopts the Joint Board mobility grant proposal (as well as the modifications to this recommendation made by AT&T and the further modifications proposed in Section VI of these comments), the complexity associated with the use of actual book costs is substantially moderated. However, even under a grant and competitive bidding method of distributing funding, the actual (projected) costs of facilities to provide the mobility or broadband universal services in the grant area should be provided by the applicant in order to allow the Commissions to determine the financial and technical viability of the proposal and to track its implementation.

[55] GCI states in its comments at page 24 that "…defining outputs and outcomes for federal programs is essential to proper management and oversight and to preventing waste, fraud and abuse."
Through the use of actual book costs, rural ILEC funding is defined specifically and verifiably, and can be demonstrably shown to provide facilities used for universal services in their service area. For rural ILECs, regulators, NECA, USAC and/or the GAO can review concrete and specific information to determine if there is waste, fraud and abuse. Currently, under the identical support rule, there is no way to determine is CETCs have a windfall or a shortfall in funding or if there is waste, fraud or abuse in CETC universal service funding. GCI is correct is its observation and CETCs should be required to provide their actual costs to prove a need for support and to allow review by regulators and others.
RCA-ARC in its comments at page 64, also argues that the Commission should not delegate cost reviews to the state commissions because it would be a burden on the states. In fact, state commissions are the best agency to review CETC costs (as they may review rural ILEC costs) because they likely have the resources and experience.

C. The use of actual book costs promotes the deployment of new technologies that provide high quality basic and advanced services to customers in low density high cost to serve areas.

Rural ILECs are on the forefront of meeting the universal service goals of the Act, largely because they are rate of return actual cost based carriers. At odds with the claims of Comcast, GCI and Cellular South, cost based regulation has proven to be an efficient means to bring the benefits of new technologies that fulfill the Act's goals for universal service to rural customers[56]. GCI asserts in its comments that rate of return regulation discourages socially beneficial behavior.[57] In fact, nothing could be further from the truth. This form of regulation encourages socially beneficial behavior largely because the carriers under rate of return cost based regulation are accountable for the costs they incur and their actions to regulators and customers.[58] In reality ETCs under other forms of regulation such as price cap regulation or no cost based regulation at all, are "perversely"

[56] NCTA wrongly asserts in its comments at page 13 that technical advances have reduced the cost of providing service. Verizon also asserts in its comments at page 23 that new technologies and more efficient practices should allow local exchange carriers to provide a consistent level of service at a lower cost. These assertions are not correct. Overall, costs to update rural ILEC network facilities are increasing, not declining – The costs of electronics may be declining, but the predominate cost to provide service (labor) is increasing (for instance, the cost of loop fiber has declined, but the trenching cost to place the fiber has increased).

[57] GCI comments at page 66.

[58] Sprint Nextel asserts on page 4 of its comments that there is no review to determine if universal service funds are well spent. This is certainly correct for CETCs that now rely on identical support, but nothing could be further from the truth for rural ILECs. Rural rate of return ILECs undergo intense scrutiny by external auditors, State Commissions, NECA, USAC, the Commission and from lending institutions such as RUS and CoBank. Rural rate of return carriers must follow Commission proscribed accounting and cost allocation rules that determine, based on the actual costs of providing service, their state and interstate rate levels and the funding they receive from the universal service funds. Every step of the accounting, cost allocation, ratemaking and universal service funding process for a rural rate of return ILEC is subject to extensive reporting, review, and if necessary reviews or audits of results by State Commissions and by federal bodies responsible for ratemaking and universal service funding disbursements (NECA, USAC and the Commission). Obtaining loans for the facilities necessary to provide universal and advanced services in high cost rural areas subjects the rural rate of return ILEC to detailed scrutiny and initial and ongoing reporting to the lender. GCI at page ii of its comments also incorrectly asserts that there is a failure to examine the 75% of the fund that is received by ILECs. As discussed above, this assertion is incorrect for the rural ILEC portion of the fund. The basis for funding for rural ILECs is thoroughly examined on an ongoing basis and the Commission has revisited the universal service rules for the rural ILECs on a frequent basis.

incented to minimize investment and the deployment of new technologies in low density rural areas. This “market force”[59] based approach leads to the provision of service in these areas with inefficient, outmoded technologies and deprives customers in these rural areas of the high quality advanced services that are available to customers of these carriers in urban areas.

D. The use of actual book costs, as RICA indicates in its comments, more accurately (than identical support) targets funding where needed.[60]

Use of actual book costs provides a direct and targeted link for the rural ILECs between their facility and operations costs in high cost service areas and the universal service funding they receive. The use of actual book costs for rural ILECs to demonstrate their need for funding and to be accountable for how that funding is used has been a success, and has clearly fulfilled the goals of the Act for universal service in the rural areas the ILECs serve.[61] In order to continue these benefits, the use of actual book cost rate of

[59] Sprint Nextel indicates that it believes the provisioning of universal service should rely on market forces on page 5 of its comments. GCI makes similar claims on page 2 of its comments where it states that the market drives service improvements and innovation. Both Sprint and GCI are incorrect. As discussed in these comments, market forces have the opposite incentive. Carriers subject to market forces are incented to serve lower cost more densely populated areas, not low density, high cost areas. GCI apparently wants the Commission to continue the now discredited policy of creating false or pseudo-competition in rural areas because, while promoting the virtues of market forces and competition on the one hand, it argues in its comments (pages 9, 17 and 19) that it would not be able to build its network facilities on a stand alone basis and would have been locked out of rural markets without support.

[60] RICA comments at page vi.

[61] In another effort to sidetrack the Commission from eliminating the identical support rule and requiring CETCs to show a cost based need for support, a number of commenter’s suggest that an alternative change would be to implement full portability by reducing ILEC funding when those ILECs lose lines. Comments of T-Mobile at page 10; RCA-ARC at pages vii, 16, 30, 59 and 65; GCI at pages 58 to 61; Time Warner at page 12; MTPCS, LLC d/b/a Chinook Wireless (Chinook) at pages 4 and 5; Cellular South at page 9; NCTA at page 11, Alltel at pages 5 and 26.

There is no need for the Commission to revisit this issue for rural ILECs. Rural rate of return ILECs have the Carrier of Last Resort (COLR) responsibility that requires that they be able to serve all customers in their service area. The full funding received is used to maintain, pay for and upgrade that COLR network. The Commission should continue to focus on correcting the real problem with the fund which is receipt of support for multiple handsets by CETCs combined with the identical support rule. These problems are responsible for the substantial fund growth.

return regulation for rural ILECs to determine their funding needs should be retained with no further caps, as discussed in the proceeding section of these comments.

If the Commission decides to use actual CETC book costs, as proposed in the Identical Support NPRM, for all CETCs or for small wireless CETCs (as proposed in Section VI of these comments), there are two feasible solutions for determining CETC costs and funding amounts – the WiCAC and the Panhandle proposal. As OPASTCO notes, both have positive attributes and could be made to work together.[62] Some commenters express concern that CETCs will have problems segregating actual book costs by area.[63] These concerns are misplaced. Assuming the Commission adopts the Joint Board recommendation to establish a separate mobility fund,[64] and if the Commission decides to base funding for mobile CETCs in that fund on their actual book costs rather than grants as proposed by the Joint Board, then there is no reason for mobile CETCs to use landline service areas (rural ILEC study area, wire center, etc), but instead mobile CETCs should use their licensed service area in a State as their universal service area. This will simplify the cost work for smaller CETCs that operate only within a state. Larger multistate mobile CETCs could either allocate their costs to their state operations (as do large wireline LECs) or if they believed that was overly burdensome, they could calculate their need for funding based on their combined operations.

Alternatively, if the Commission adopts the Joint Board recommendation to establish a separate mobility fund, but also adopts the Joint Board's recommendation that that fund

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In a further effort to sidetrack the Commission, RCA-ARC claims at page 10 of its comments that only 40% of ILEC support is cost based. At odds with this assertion, ***all*** rural ILEC universal service funding is cost based. Unlike CETCs, all ILECs must cost justify their funding levels based on actual (experienced or embedded) costs. This is true even for average schedule ILECs. Their funding is based of actual costs of similar sized and situated rural ILECs that file cost studies with the NECA.

[62] OPASTCO comments at page iii. See also RICA comments at page vi.

[63] GCI comments at page 71; Sprint Nextel comments at pages 9 and 10; RCA-ARC at page 60.

[64] Joint Board NPRM, Appendix A, paragraph 16.

be a grant based fund to provide funding for mobility in unserved or underserved areas, the Commission should still insist that mobile carriers seeking grants provide (projected) cost based funding for the grant proposal. The grant proposal should significantly reduce the complexity associated with the use of actual book costs. However, even under a grant and competitive bidding method of distributing funding, the actual (projected) costs of facilities to provide the mobility or broadband universal services in the grant area should be provided by the applicant in order to allow the Commissions to determine the financial and technical viability of the proposal and to track its implementation.

VI

THE JOINT BOARD RECOMMENDATION TO ESTABLISH SEPARATE POLR, BROADBAND AND MOBILITY FUNDS, WITH CERTAIN MODIFICATIONS, SHOULD BE ADOPTED BY THE COMMISSION

A. Minimal changes are required for the rural ILEC POLR funds.

1. Embedded costs as the basis for funding should be retained for rural ILECs. The existing rural ILEC universal service funds (HCLS, LSS and ICLS) are operating as intended by the Act and are allowing rural ILECs to deploy, maintain and upgrade a universally available network with access to basic and advanced services at just, reasonable and affordable rates, and only minimal changes are necessary. AT&T points out in its comments that, "Rate of return (ROR) ILECs have made significant progress in the deployment of broadband facilities in the areas they serve. These companies have in large part accomplished this progress primarily through the funding they receive from the existing federal high-cost mechanisms."[65] As discussed in section V of these comments, the use of actual embedded costs by rural ILECs (a) reflects the changing mix of

[65] AT&T comments at page 24. TDS makes similar observations at page 5 of its comments.

technologies deployed by a rural ILEC as it upgrades its facilities to provide basic and advanced services to customers (b) incents rural ILECs to meet the goals of the Act by deploying facilities capable of providing advanced services, (c) deters waste, fraud and abuse because regulators can determine if a rural ILEC needs funding, how much funding is required, and allows regulators to review the basis for funding and if necessary, audit the basis for and use of the funding and (d) encourages socially beneficial behavior largely because the carriers under this form of regulation are accountable for the costs they incur and their actions to regulators and customers. To retain these benefits, the existing rural ILEC funds and their embedded cost basis must be retained.

2. Rural ILEC funds should not be capped. As discussed in section IV of these comments, and overall cap on rural ILEC funds is inappropriate because (a) rural ILECs are not contributing to the growth of the fund, (b) an overall cap would redistribute rural ILEC cost based support to large ILECs and CETCs and (c) it is at odds with rate of return regulation and would preclude rural rate of return ILECs from an opportunity to earn the authorized return. A permanent cap is also at odds with the Acts requirement that the funds be predictable and sufficient. For similar reasons, further individual caps should not be placed on other rural ILEC funding elements that are currently uncapped (LSS and ICLS). Rural ILECs are continuing to upgrade their facilities to improve the delivery of basic and advanced services to *all* customers in their service area and an overall cap or further capping of individual funding elements would impede or stop this deployment. In fact, rural ILECs should be incented to continue to deploy advanced networks for their customers, not disincented by further caps and the existing cap on the HCLF. The existing cap on the HCLF has made it more difficult to deploy upgraded networks in rural ILEC areas. Lifting the cap would provide rural ILECs with greater incentives and the ability to continue to upgrade their facilities so that their customers can have access to broadband services comparable to those offered in urban areas. However, if the Commission decides not to lift the cap entirely, at the very least it should re-base the cap.[66] This minimal change to the fund would allow rural ILECs with a reasonable opportunity to earn their authorized return by recovering costs that are unrecoverable under the current HCLF cap and facilitate further network investments.

3. Reverse Auctions should be rejected for rural ILECs. As discussed in section III of these comments, reverse auctions are unworkable for rural ILECs and completely at odds with rural ILEC cost based rate of return regulation.

4. Rural ILEC and non-rural ILEC funding should not be combined under one mechanism. A small number of commenters indicated that the Commission should develop a unified funding mechanism that could be applied to all ILECs.[67] These commenters also noted that the Joint Board "…did not design a new and unified system for Providers of Last Resort…"[68] The Joint Board was correct and the commenter's proposal should be rejected. First, the issue before the Joint Board involving funding growth would not be resolved by a unified POLR fund. Rural ILECs are not causing the fund growth. Second, this issue has been reviewed by the Commission a number of times, and it has repeatedly decided that because of their differences, rural and non-rural ILECs should be funded by differing mechanisms. Finally, although FWA has no

[66] AT&T on page 25 of its comments proposed that "The Commission could also re-index the current high-cost loop fund…as an additional incentive to offer broadband service. Re-calibrating the high-cost loom mechanism will provide ROR ILECs that have a high-cost loop infrastructure with an additional cost recovery opportunity, which, in tern, will provide a further incentive for those companies to offer broadband services to their customers."

[67] Comments of Maine Public Utilities Commission, ConnectME Authority, the Wyoming Public Service Commission and the Vermont Department of Public Service at page 10.

[68] Id.

objection to additional funding for rural areas of the non-rural ILECs, if additional funding is provided, it should not come from the funding currently received by rural ILECs as could be the case with a POLR fund that has an identical universal service methodology for both rural and non-rural ILECs. This would result in insufficient funding for all ILECs and penalize the only carriers (rural ILECs) that have been delivering on the promise of the Act to bring quality basic and advanced service to all rural customers in the areas they serve.

B. The AT&T modifications for the broadband fund appear reasonable.[69] However, the Commission should target this funding to Price Cap ILEC areas. Rural ILECs should be designated as the broadband providers in their service areas.

As AT&T notes in its comments, rural rate of return ILECs are, because their rates and universal service funding are based on their network costs, able to deploy both basic and advanced services in their service areas.[70] Price Cap ILEC universal service funding is likely insufficient to fund broadband deployment in Price Cap ILEC high cost areas because the basis for their funding is a cost model that primarily recognizes only voice service costs. Additionally, Price Cap ILECs have likely not widely deployed broadband in their high cost to serve areas because (a) market based rates will not support the high capital and ongoing costs of broadband deployment[71] and/or (b) Price Cap ILECs have

[69] AT&T comments at pages 11 and 12, 15 and 16, 21 to 23 appear to be reasonable, except that the proposed voice service capabilities should meet those now required by the Commission and should not be streamlined as proposed by AT&T on page 12 of its comments. Additionally, the proposed modifications made by AT&T for the areas eligible for support and allocating funds among states (pages 13 and 14), the application process (pages 18 to 20), the application review and selection process (pages 20 to 21) and the lifeline designation process for internet access (pages 25 to 27) appear reasonable.

[70] Id., page 15 and 24.

[71] Verizon in its comments at 27 and 31 claims there is no need for a fund because government/provider partnerships can be used to deploy broadband. The New York Public Service Commission makes similar statements at page 6 of its comments. NCTA in its comments at pages 19 and 22 also claims there is no need for a fund. Because the market is already working and meeting customer needs. NCHT makes similar

been unable, due to competition in their low cost markets or unwilling, because of real or perceived stockholder revenue demands, to internally subsidize or flow funds to their high cost areas to fund broadband deployment. Because of these Price Cap ILEC differences, there is generally a high availability of broadband in rural ILEC service areas, while there is a low availability in the high cost areas of Price Cap ILECs.

If the Commission (a) maintains the universal service funding mechanisms for rural ILECs, (b) lifts or resets the cap on the High Cost Loop Fund (HCLF) as proposed by AT&T[72] and (c) stabilizes the rural ILEC access revenues as proposed in section VIII of these comments and by AT&T[73], rural ILECs will be able to continue to deploy, upgrade and maintain networks capable of providing broadband service. As a consequence, support from the broadband fund would be unnecessary in areas served by rural ILECs. On the other hand, to increase the availability of broadband facilities in Price Cap ILEC service areas, some type of funding will be necessary. The Joint Board recommendation, as modified by AT&T in its comments is appropriate to accomplish this objective. Finally, as the Joint Board recommended, there should be only one supported wireline broadband provider in an area.[74] In rural ILEC areas where universal service funding is for the network, and access charge revenues are allowing the rural ILEC to provide networks capable of providing voice and advanced services, the rural ILEC should be designated as the broadband carrier in order to insure that wasteful duplicative funding is not provided to another carrier.

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arguments at page 21 and 22 of its comments – No need for this fund – 99.6% of zip codes are already served - market forces might provide broadband to rural areas. The facts are however, that government/provider partnerships and market forces have not made broadband facilities generally available in low density high cost to serve areas of Price Cap ILECs.

[72] AT&T comments at page 25.

[73] Id.

[74] Joint Board NPRM, Appendix A, paragraph 15.

C. The mobility fund modifications proposed by AT&T[75] appear reasonable, except that for small regional wireless CETCs, ongoing funding for upgrades and operational expenses is necessary.

With funding from the mobility fund, large wireless ETCs will be able to construct facilities that provide basic and advanced services in their rural high cost areas. These large carriers will also be able to maintain and upgrade their facilities with funds provided from their urban, low cost to serve areas and thus will not need ongoing funding for these facilities and services. However, this is not the case for small regional wireless CETCs. These carriers serve primarily rural areas within a state and if the only funding they receive is for the initial construction costs, they do not have the urban customer base that will allow them to use internal funding to maintain and upgrade facilities deployed in high cost to serve areas. Without ongoing funding for maintenance, operational expenses and the cost to upgrade their networks, these small wireless carriers, will not only be unable to expand their network to serve high cost, low density areas within their licensed service area, but may be unable to survive financially. The Commission should strive to insure that these small carriers survive because they provide local jobs and revenues that support rural communities and generally excellent, localized customer service.

There are major differences between small regional and large wireless CETCs that justify a different funding mechanism for small rural wireless CETCs. The focus of larger

[75] AT&T comments at pages 12 to 13, 16 to 18, and 23 to 24 except that the proposed voice service capabilities should meet those now required by the Commission and should not be streamlined as proposed by AT&T on page 13. Additionally, the proposed modifications made by AT&T for the areas eligible for support and allocating funds among states (pages 13 and 14), the application process (pages 18 to 20), the application review and selection process (pages 20 to 21) and the lifeline designation process for internet access (pages 25 to 27) appear reasonable.

wireless carriers is on serving denser urban markets, and on the profits that they can bring to their shareholders or equity owners. In contrast, smaller regional carriers focus on using universal funding to build out networks to serve low density rural markets.

The largest share of CETC funding and funding growth is as a result of large multistate wireless carriers. Table B below shows a breakdown of wireless CETCs above and below 50,000 lines and the universal service funding received. In 2008, large CETCs received $1,172M or 82% of the total wireless CETC support while smaller regional wireless CETCs received only $259M or 18 % of total wireless CETC support.

Table B[76]

Estimated Annual USF Fund Payments to Wireless CETCs	
CETC:	**2008 USF**
ALLTEL/WESTERN WIRELESS/MIDWEST WIRELESS	$410,750,521
AT&T WIRELESS (CINGULAR)	$273,784,705
UNITED STATES CELLULAR	$182,980,296
SPRINT SPECTRUM, LP	$79,007,190
CELLULAR SOUTH LICENSE, INC.	$67,691,421
CENTENNIAL COMMUNICATIONS CORPORATION	$50,888,302
RURAL CELLULAR CORPORATION	$50,197,606
NPCR, INC.	$30,687,725
BLUEGRASS CELLULAR	$16,243,725
SMITH BAGLEY, INC.	$7,103,844
VIRGINIA/WEST VIRGINIA PCS ALLIANCE DBA NTELOS	$2,263,798
CETC > 50,000 lines	**$1,171,599,133**
CETC < 50,000 lines **(137 Carriers as of 3rd qtr 2008 projections)**	**$259,134,975**
TOTAL Wireless CETCs Receiving Support	**$1,430,734,108**

[76] Lines and support amounts were gathered from USAC's HCL and IAS line counts as reported to USAC and used for 3Q2008 FCC projections. These files are publicly available for download at: http://www.usac.org/about/governance/fcc-filings/2008/quarter-3.aspx The Joint Board Monitoring report, released December 28, 2007 contained reports in Section 3 which aided in the identification of wireless CETCs. Public data regarding recently granted wireline/wireless CETCs is not currently available and as a consequence some small CETCs may be included/omitted in the totals. Information regarding subsidiaries and acquisitions was obtained through both recent news reports and SEC 10k1 filings.

The Joint Board has proposed a universal service funding plan that relies on funding for capital expenditures through a grant program. This proposal recognizes that large CETCs, as a result of their economies of scale have the means to fund and recover the ongoing costs of universal services in their rural areas. Limiting universal service funding to large CETCs to a reasonable and practical amount (initial capital expenditures), places the burden on these carriers to assist in the support and build out their rural operations through internal funding achieved through their economies of scale. For large CETCs, the Commission should still require the application to show the projected costs of the proposal in order for the Commissions to be able to evaluate the financial and technical validity of the grant application.

Alternatively, universal service funding for smaller regional CMRS ETCs[77] should be based on their ongoing actual or embedded costs. As shown in Table B, ongoing funding for small rural CETCs will not burden the fund. An overall costing process such as the Panhandle or WiCAC costing proposals can be utilized. Costs would be reported to USAC and the applicable State Commission. FWA believes that it is appropriate for the State Commission to have the primary responsibility to review and approve the reported costs. A process similar to that described in 47 C.F.R. 36.621, 36.622 and 36.631 for rural ILECs can be used by the Joint Board to determine the cost based funding levels for the small CMRS ETCs.

[77] The Joint Board and Commission should evaluate an appropriate division of small regional versus large CMRS ETCs. As shown in Table B, 50,000 lines nationwide may provide an appropriate subdivision.

D. The Sprint Nextel proposal does little to resolve universal service issues and should be rejected.

On May 12, 2008, Sprint Nextel filed a proposal with the Commission in WC Docket 05-337 and CC Docket No. 96-45 that purports to “comprehensively address” universal service issues raised by the Joint Board. In fact this proposal does nothing but raise SLCs and inappropriately reduce universal service funding in ILEC areas where CETCs have some portion of the market. The plan does nothing about identical support, showing a cost based need for funding, receipt of support for multiple wireless handsets, promoting broadband or mobility deployment in rural areas, etc. The sole purpose of the plan seems to be to reduce universal service funding primarily through SLC increases.[78] The second largest component of the plan is a capping or reduction of universal service funding in areas where there is over 25% CETC penetration in an ILEC area. This ill advised proposal leaves multiple CETCs in place while insuring that insufficient funding is available to deploy, maintain and upgrade rural ILEC networks capable of providing all customers (not just 25% or 50% or 75%) with access to universal services, comparable to those offered in urban areas at just, reasonable and affordable rate levels. The Sprint Nextel plan should be rejected by the Commission.

[78] If SLCs are to be increased, it should be for the purpose of rationalizing the intercarrier compensation regime as discussed in Section VIII of these comments in order to preserve revenues that will be used to deploy broadband capable facilities in rural areas.

VII

IF FUND GROWTH IS TO BE BROUGHT UNDER CONTROL, THE IDENTICAL SUPPORT RULE MUST BE ELIMINATED

In the Identical Support NPRM, the Commission tentatively concluded that the identical support rule should be eliminated. No commenter has presented any credible evidence or facts that justify retention of the identical support rule.

A. Elimination of the Identical Support Rule and the use of actual costs by all ETCs (incumbent and competitive) to demonstrate a need for funding is competitively and technologically neutral.

A few commenters objected to the elimination of the identical support rule based on incorrect claims that identical support insures funding distribution is competitively neutral and encourages competitive entry. They wrongly assert that elimination of identical support will hinder competitive entry.[79] The fact is that the identical support rule never was competitively or technologically neutral.

SouthernLINK states that "The rules for distributing universal service support should be identical for all ETCs without regard to the type of technology they use or the type of competition (e.g. incumbent or competitor)…."[80] The identical support rule has never met this requirement and instead as RICA notes, "…turns the concept of neutrality on its head."[81] The identical support rule wrongly and at odds with competitive and technological neutrality, treats CETCs as if their cost structures were identical to the ILEC's and ignores the material differences between wireline and wireless technologies.

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[79] RCA-ARC comments at page iv and v.; United States Cellular Corporation (USCC) makes similar, if not identical assertions in its comments; Alltel comments at page 22.
[80] SouthernLINK comments at page 15. RCA-ARC makes a similar observation on page 40 of its comments where it states "All providers of the supported services must be treated equally."
[81] RICA comments at page 14.

Commenters supporting the retention of identical support incorrectly assert that the independent development of ILEC and CETC costs using a different basis and criteria would violate competitive neutrality. They wrongly claim the difference in the level of funding caused by the proposed replacement for identical support (actual costs) gives one competitor a competitive advantage over another competitor and that unequal support funding is not competitively neutral – competitively neutral means all competitors are entitled to the same level of funding.[82] These claims are factually wrong. "The rule that provides support to one carrier based on another carrier's significantly different cost structure has neither plausible theory underlying it, nor empirical evidence in its support. The rule serves no purpose except to encourage waste…"[83] As the Oklahoma Corporation Commission states in its comments "Incumbent LECs have many obligations that increase their underlying costs, including, but not limited to minimum service standards placed on wireline technology, the obligation to provide ubiquitous service, and state regulatory obligations. Competitive ETCs, particularly wireless ETCs, are not subject to many of the obligations placed on incumbent LECs. The goal of competitive neutrality is not well served when competitive ETCs share the benefits of USF support but do not share all the burdens placed on incumbent LECs."[84]

Competitive and technological neutrality can only be achieved when differing types of ETCs are subject to identical rules (within their fund type) that require each ETC to demonstrate a cost based need for funding. This will insure that universal service funding provided to all ETCs, irrespective of the type of technology they deploy, is

[82] RCA-ARC comments at pages 8, 10, 14, 15, 27 and 53. Sprint Nextel makes similar incorrect assertions in its comments at page 7.
[83] RICA comments at page 15.
[84] Oklahoma Corporation Commission comments at page 10. The Kansas Rural Independent Telephone Companies (KRITC) male similar comments on page 3 of their comments.

causally connected to the costs they incur and provides a clear auditable trail to determine how any ETC spent the universal service funding it receives.[85] The identical support rule in fact, and at odds with the assertions of its supporters, may provide a competitive advantage to its recipients by giving them funding in excess of their cost based need. The inability to determine if these recipients actually need the funding causes an inability to determine where and for what the funds are used and has a clear potential for waste, fraud and abuse. The rule also encourages uneconomic competitive entry where funding per-line and customer density is the highest and discourages entry where customer density is low.[86] Further, wireless carriers receive support based on the number of handsets provided which may consist of multiple handsets for each household or equivalent line. This approach is clearly a mismatch with the incumbent LEC's per-line support costs. These false market signals have led to substantive and unwarranted funding increases to CETCs.

For these reasons, the identical support rule must be eliminated and replaced by a cost based system (either as proposed in the Identical Support NPRM, or under a grant based system for mobility and broadband as proposed in the Joint Board NPRM) that encourages CETCs to provide service in high cost, low density areas and that requires CETCs to demonstrate a need for funding.

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[85] The Public Service Commission of the State of Missouri states in its Identical Support NPRM comments at page 5 that "Basing each carrier's support on its own costs is competitively neutral….no carrier will reap a potential windfall or be caused financial distress based on support dependent on the costs of an unrelated carrier."

[86] RCA-ARC in its comments at pages 33 and 34 incorrectly claims that identical support promotes competition in rural areas which in tern promotes efficient investment, and that the Commission is wrong in its contention that identical support gives little incentive to invest in low population density areas. At odds with RCA-ARC's assertions, the Commission is correct. The identical support rule does provide a perverse incentive to construct facilities only in more densely populated areas in order to maximize handsets served and thus maximize identical support.

B. The Commission presents substantial evidence that justifies eliminating the Identical Support rule

RCA-ARC claims that the Commission should not eliminate identical support because it presents virtually no evidence supporting its CETC support growth assumptions and failed to show the problem. RCA-ARC further asserts that the Commission must show that near term growth will cause the fund to be unsustainable, that CETCs are the cause and that elimination of identical support is the only option.[87]

These claims and assertions are wrong. The Commission is under no obligation to show that elimination of identical support is the only option. Hopefully, however, the Commission will adopt the best option and the most sensible course of action which is to eliminate the identical support rule. That rule was neither competitively or technologically neutral in first place, and has had the following negatives effects enumerated by the Commission:

- Identical support is causing significant growth of the universal service fund resulting in fund instability. The Commission provided an analysis of the significant growth of CETC support in paragraphs 3 and 4 of the Identical

[87] RCA-ARC comments at pages v, 17 and 18. RCA-ARC also wrongly claims on pages 4 and 25 of its comments that there is no convincing evidence that universal service support is in danger of being destabilized and that the rate of CETC growth is declining. RCA-ARC presents a table on page 25 of its comments that purports to show (wrongly) that "The predictions made by the Joint Board appear doubtful in light of the recent downward trend in the growth of competitive ETC funding." If fact, this is simply an attempt to obscure the facts. The table shows that the percentage year over year growth of CETC support is declining, but the facts are that the absolute total funding provided to CETCs under the identical support rule is substantially increasing as both the Joint Board and Commission have established. The table simply shows that the percent increase of a large support number in 2006/2007 is smaller that in earlier years when the CETC support levels were smaller.

Support NPRM[88] and stated that identical support needed to be eliminated "To insure the sufficiency of the universal service mechanism…"[89]

- The identical support rule "…bears no relationship to the amount of money such competitive ETCs have invested in rural and other high-cost areas of the country."[90]
- "…instead of competitive ETCs competing against the incumbent LECs for a relatively fixed number of subscriber lines, the certification of wireless competitive ETCs has led to significant increases in the total number of supported lines. Because the majority of households do not view wireline and wireless services to be direct substitutes, many households subscribe to both services and receive support for multiple lines."[91]
- "…the identical support rule fails to create efficient investment incentives…the competitive ETC has little incentive to invest in, or expand, its own facilities in areas of low population density, thereby contravening the Act's universal service goal of improving the access to telecommunications services in rural, insular and high-cost areas."[92]

Based on this well supported rationale, the Commission concluded that the identical support rule should be eliminated and CETCs seeking support would need to show a need

[88] The Commission noted in paragraph 4 of the Identical Support NPRM that ILEC funding has been flat or had declined. Clearly then, the Commission has shown that the CETCs are the cause of the fund growth because ILEC funding has not grown. See also Table A in these comments.
[89] Identical Support NPRM, paragraph 5, footnote omitted.
[90] Id.
[91] Id, paragraph 10, footnotes omitted. Alltel claims on pages 9, 10 and 23 of its comments that ILECs and wireless CETC's compete directly with each other and that customers view these services as substitutes not complementary services. As evidence, Alltel cites a study that shows that 13.6% of households use only a wireless phone.
Alltel is wrong as the survey it cites demonstrates – 86.4% of households either have complementary wireline and wireless services or wireline only service.
[92] Id.

for funding based on actual book costs. This conclusion, if adopted by the Commission will be consistent with and support the universal service goals of the Act in section 254.

VIII

FURTHER REVISIONS IN ACCESS RATE LEVELS ARE ESSENTIAL TO MAINTAIN A STABLE AND SUSTAINABLE BASE OF REVENUES SO THAT THE GOALS OF THE ACT CONTINUE TO BE ACHIEVED IN RURAL HIGH COST SERVICE AREAS

All of the existing rural ILEC federal universal service funding (HCLS, LSS and ICLS) was at one time recovered in the rural ILECs' access rates and still represent cost based recovery of loop or local switching costs of the rural rate of return ILEC. As discussed by AT&T in its comments,[93] further revisions in access rate levels are essential to maintain a stable and sustainable base of revenues so that the goals of the Act continue to be achieved in rural high cost service areas.

A. Access charge and universal service revenues are essential cost recovery mechanisms to fulfilling the Act's universal service objectives in rural ILEC service areas

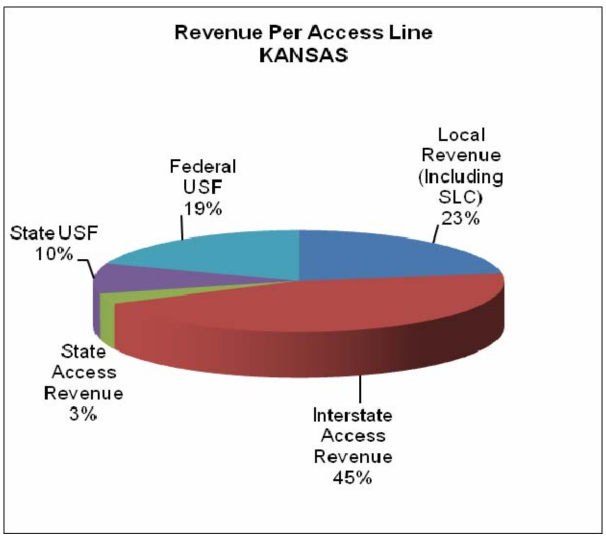
As shown in Table C below, universal service revenues (cost-based revenues previously recovered in access charge rates) and state and interstate access charge revenues recover a major portion of the high facility costs for rural ILECs.

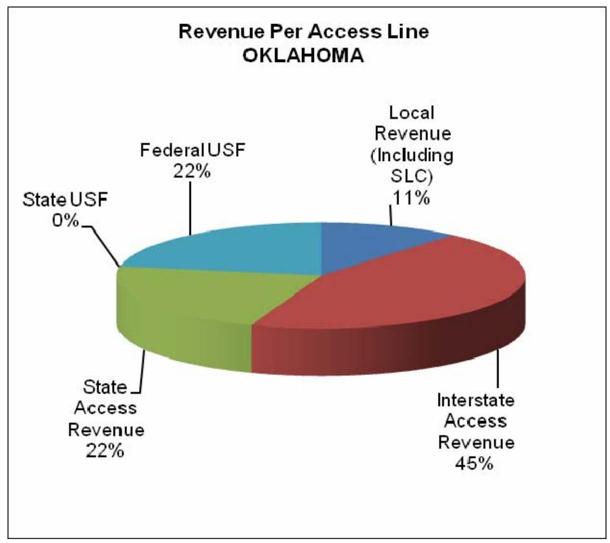
[93] AT&T comments at pages 27 to 29.

Table C[94]

Revenues Per-Line for Certain Rural ILECs in Kansas and Oklahoma

Description	KANSAS Monthly Revenue Per Access Line	KANSAS %	OKLAHOMA Monthly Revenue Per Access Line	OKLAHOMA %
Local Revenue (Including SLC)	**$ 35.00**	**23%**	**$ 5.00**	**11%**
Interstate Access Revenue	**$ 70.00**	**45%**	**$ 20.00**	**45%**
State Access Revenue	**$ 5.00**	**3%**	**$ 10.00**	**22%**
State USF	**$ 15.00**	**10%**	**$ -**	**0%**
Federal USF	**$ 30.00**	**19%**	**$ 10.00**	**22%**
Total	**$ 155.00**	**100%**	**$ 45.00**	**100%**





Federal universal service revenues, along with the other sources of revenue, including existing interstate and state access revenue, allow rural ILECs to maintain and upgrade high cost facilities used to provide universal services comparable to those offered in urban areas at just, reasonable and affordable rate levels, as required by the Act. For the rural ILECs depicted in Table C, without interstate universal service revenues, local service rates, on the average for these companies, would increase by $25.00/line/month.

[94] Source: Revenue information from 2007 financials of a portion of the rural LECs in Kansas and Oklahoma

Substantial local rate increases would also be necessary if substantial levels of access charge revenues are lost. It is becoming more and more critical for the Commission to complete access reform because the number of unbillable minutes continue to increase.

B. Sustainable and predictable universal service fund revenues are used by rural ILECs to deploy facilities capable of providing both basic and advanced services.

With a sustainable and predictable flow of federal universal service and interstate and intrastate access charge revenues, rural ILECs provide modern switching and loop facilities that are used to deploy ubiquitous universal services and advanced services as required by the Act. Table D shows, on the average, the density of certain rural ILECs and the level of broadband coverage they provide.

Table D

Broadband Deployment

	Lines Per Square Mile	**Current % of DSL Equipped Lines**	**2-3 Year Target % of DSL Equipped Lines**
Average for certain companies in Kansas:	**3.7**	**85%**	**97%**
Average for certain companies in Oklahoma:	**6.3**	**92%**	**100%**

C. For rural ILECs, access charges and universal service funding are inextricably linked and long term universal service fund reform must deal with intercarrier compensation.

As demonstrated in Table C, for rural ILECs, both intercarrier compensation (cost-based access charge revenues) and universal service fund revenues (previously recovered in cost-based access rates) are essential for the continued maintenance and deployment of facilities in rural areas that are required to provide basic and advanced services at just, reasonable and affordable rates comparable to those charged in urban areas. Advances in technology, arbitrage, phantom traffic and Commission decisions have jeopardized the sustainability of access charge revenues. As AT&T states in its comments, "… broadband Internet access and VoIP services have largely avoided access charges, depriving ILECs of revenues on which they have relied to offer…POTS service…"[95] The Missoula Plan provided the Commission with a workable and industry developed means to deal with this problem and to preserve the rural ILEC cost-based revenues necessary to fulfill the Act's universal service requirements by lowering intrastate access rates to interstate levels and recovering the revenues no longer recovered in usage based access rates from SLCs and a Restructure Mechanism. If the Commission cannot, in the context of universal service reform adopt the entire Missoula plan at this time, it should, at a minimum reform access charges for ILECs as follows:

1. Require that all carriers and providers that use the ILEC networks (including VoIP providers and facilities based broadband internet providers) pay applicable access charges.[96]

2. Adopt phantom traffic requirements proposed by NECA[97] so that ILECs can determine which carrier or provider should be billed access for the use of the ILEC's network.

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[95] AT&T comments at page 28.

[96] NECA comments at pages 33 and 34; TDS comments at page 11; National Consumer Law Center comments at page 5; AARP comments at pages 30 and 31; NTCA comments at pages 9 to 12.

[97] NECA Petition for Interim Order in CC Docket 01-92, filed on January 22, 2008.

3. As proposed by AT&T in its comments, reduce intrastate access charges to interstate levels.[98] If the Commission believes that this is too large a change, then it should preserve intercarrier revenues that are required by rural ILECs by adopting a plan that insures that intrastate access rates and structure mirror interstate access rates and structure for rural rate of return ILECs.

4. To offset the revenue losses from these access rate and structure changes on a revenue neutral basis, implement the Missoula Plan subscriber line charge (SLC) rate changes and the Plan's Restructure Mechanism or as AT&T proposes in its comments on page 29, some combination of SLC increases and a Restructure Mechanism on a revenue neutral basis.

5. Implement a federal benchmark mechanism as discussed by AT&T on page 29 of its comments.

IX

OTHER NECESSARY UNIVERSAL SERVICE REFORMS

A. A comprehensive plan to revamp federal universal service fund mechanisms must change the basis of contribution

The NPRMs do not address the basis of contribution or recovery of universal service funding. The Commission has before it a significant amount of documentation and information that clearly shows that the current funding basis (interstate retail revenues) is declining while the fund and funding requirement is increasing. As a consequence, the universal service surcharge on interstate retail revenues continues to increase. This surcharge provides an inequitable and unsustainable burden on one segment of the telecommunications industry. A comprehensive plan to revamp federal USF mechanisms

[98] AT&T comments at page 28.

must change the basis of contribution from interstate retail revenues to a broader and more sustainable base such as working telephone numbers and connections. This would assure that all providers that are receiving the benefit of universal service are contributing to the fund.

B. The parent trap rule is harming service to rural Americans and should be eliminated.

Over twenty years ago, the FCC adopted a rule, which has now become known as the "parent trap" rule, which required that any carrier which acquired exchanges from another company would be limited to the same amount of universal service funding per line as that received by the selling company.[99] The rule was originally adopted to ensure that the purchasing company would not rely on its ability to obtain universal service funding after the sale.[100] Recognizing that the parent trap rule caused hardships on carriers serving rural Americans by not encouraging investments subsequent to acquisitions, the Commission later adopted the "safety valve" rule to provide some funding to a carrier based on a significant amount of increased investment in the purchased exchanges.[101] The safety valve rule however, has been woefully inadequate in addressing the needs of rural carriers and should now be viewed as a failed experiment.

Periodically, rural ILECs purchase exchanges from larger carriers. These rural ILECs are (a) accustomed to serving these rural territories, (b) committed to providing quality services to rural Americans and (c) willing to invest money to bring modern and

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[99] Section 54.305 of the Commission's Rules.

[100] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, 12 FCC Rcd 8776, 8943, paragraph 308 (1997).

[101] Federal State Joint Board on Universal Service, Fourteenth Report and Order, 16 FCC Rcd 11244, 11284, 11293, at paragraphs 97-119 (2001); 47 C.F.R. section 54.305(d). The rule only funds half of the support that the company would be entitled to under the regular formula and is only available to those carriers who already qualify for USF in the first place.

advanced services to these communities. Section 254 of the Act mandates that the FCC provide sufficient funding to rural areas to promote affordable and modern communications for rural Americans. The parent trap rule needs to be substantially modified to provide reasonable universal service funding to exchanges acquired by rural ILECs so that they can be upgraded and modernized. Maintaining the current parent trap rule dooms customers in these acquired exchanges to second-class citizenship because the acquiring rural ILEC service providers cannot get universal service funding that is sufficient to recover the costs of providing a modern network.

If the FCC does not completely eliminate the parent trap rule, it should strongly consider serious modification. Instead of limiting funding to the same per-line funding that the seller received (based on average costs of all exchanges served by the seller), the FCC should provide at a minimum the same overall dollars that the seller was receiving from the sold exchanges (based on the costs of serving the sold exchanges).[102] Alternatively, the Commission could increase substantially the portion of funds provided by the safety valve rule by eliminating the 50 percent limitation.

Respectfully submitted by,

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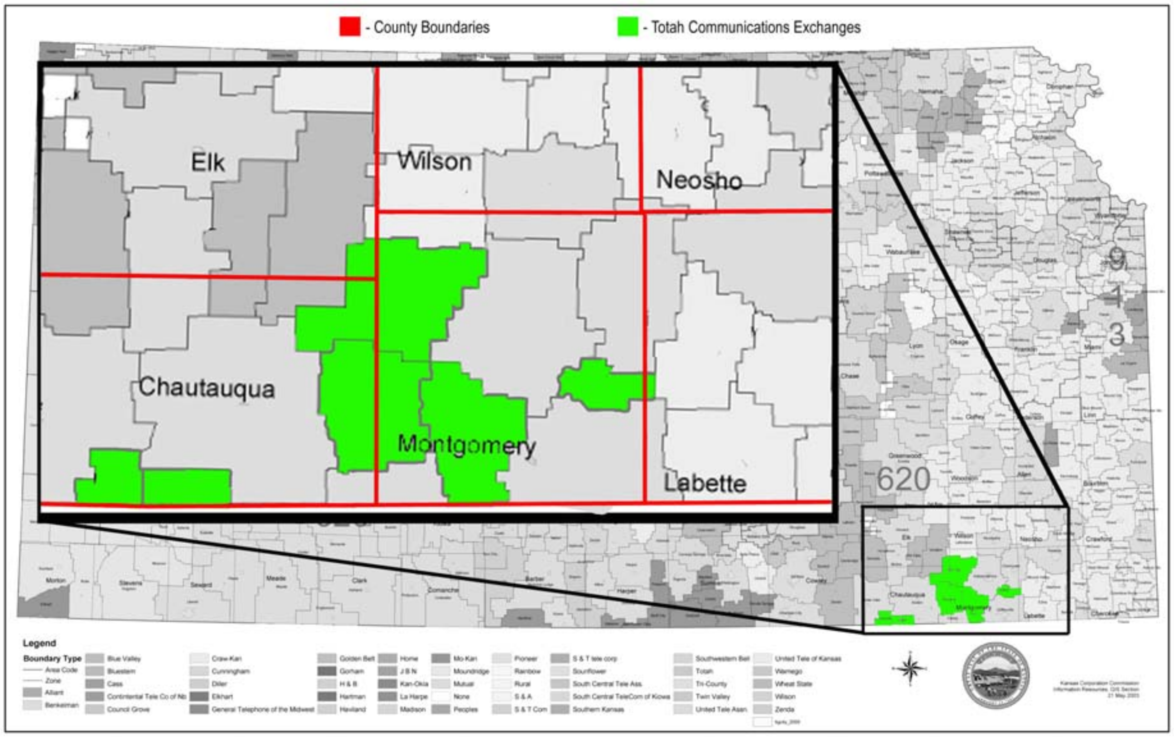
Paul L. Cooper
President, Fred Williamson & Associates, Inc.
5810 E. Skelly Drive, Suite 900
Tulsa, OK. 74135
Telephone: (918) 298-1618

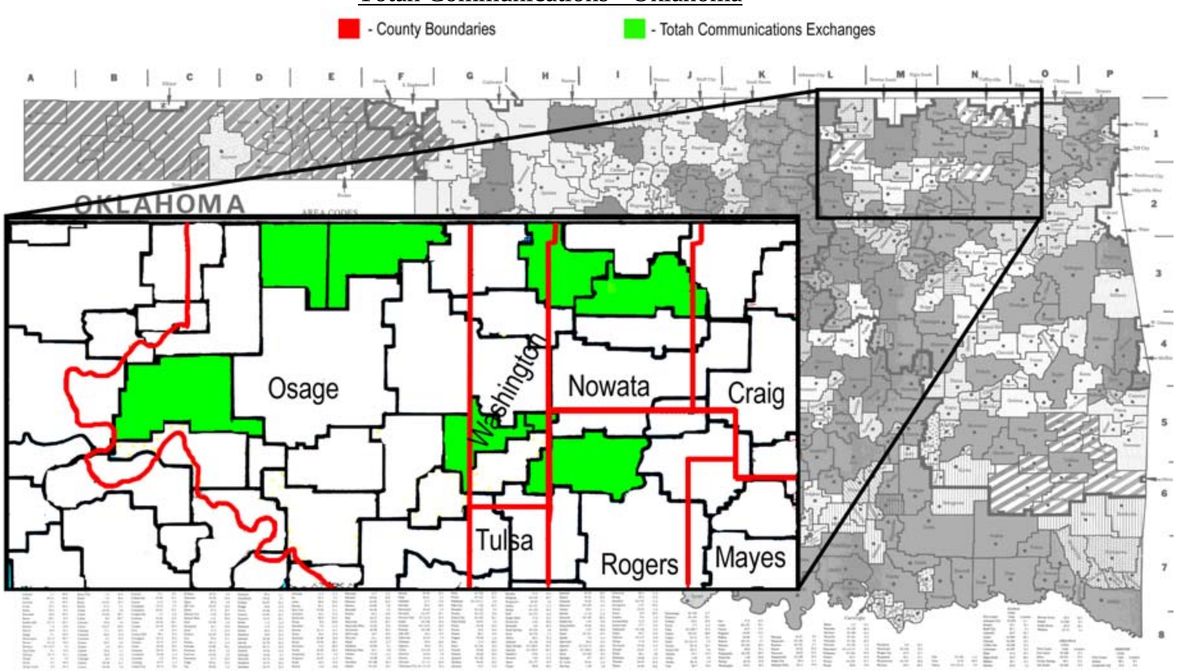
[102] See United Telephone Company of Kansas, et al., Petition for Clarification or Waiver of Section 54.305 of the Commission's Rules, Application for Review, CC Docket No. 96-45 (filed Oct. 10, 2006). Thus, if a seller received USF of $100,000 from the exchanges prior to sale, that same $100,000 should be the maximum that the acquiring company could receive after the sale.

Counties do not match the footprint of rural ILECs and therefore are inappropriate to use as a reverse auction area. As an example, Totah Communications service area in Kansas and Oklahoma is much smaller than the counties that encompass it.

Totah Communications – Kansas



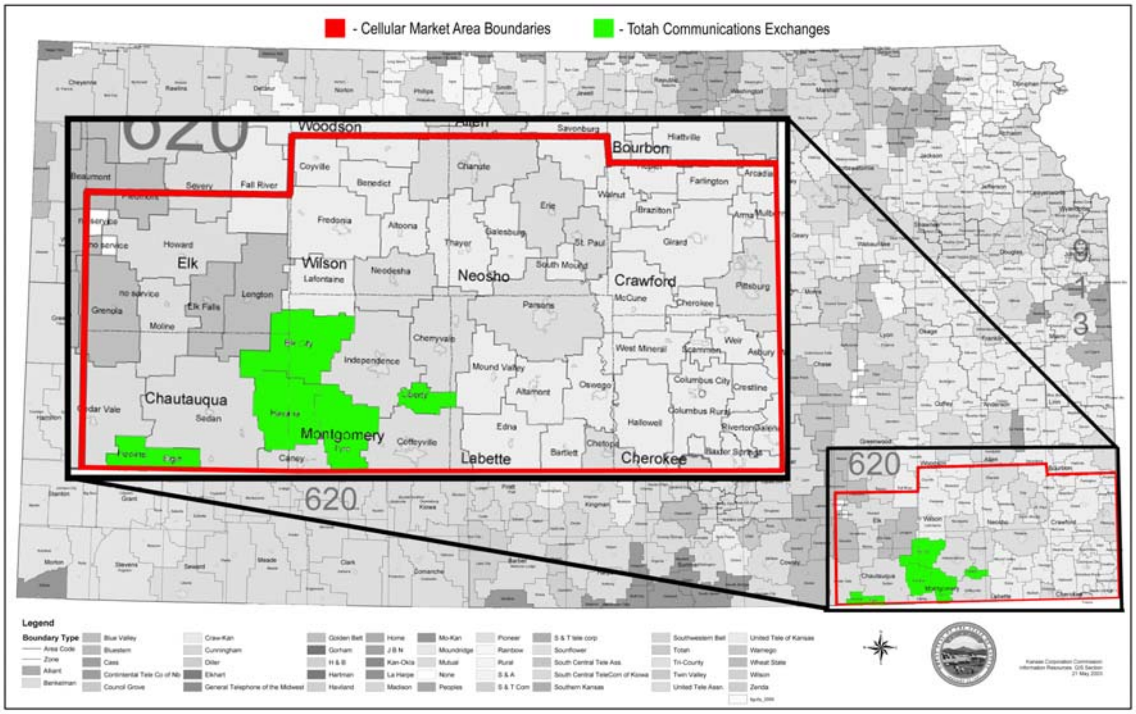
Totah Communications - Oklahoma



Attachment 2

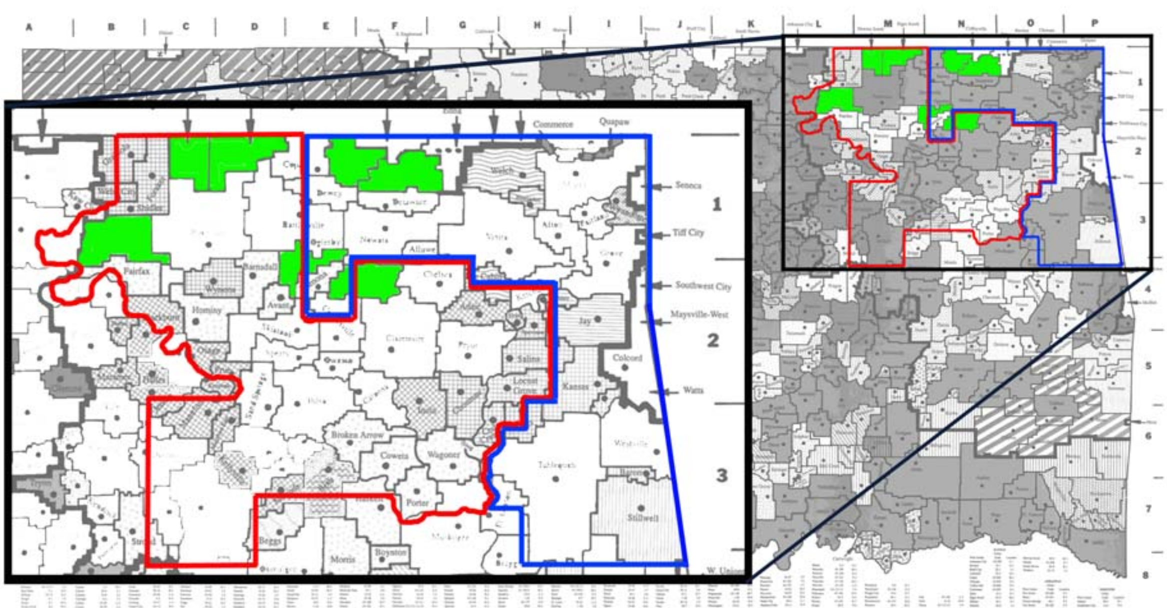
Cellular Market Areas (CMA) do not match the footprint of rural ILECs and therefore are inappropriate to use as a reverse auction area. As an example, Totah Communications service area is much smaller than the CMAs that encompass it.

<u>Totah Communications – Kansas</u>



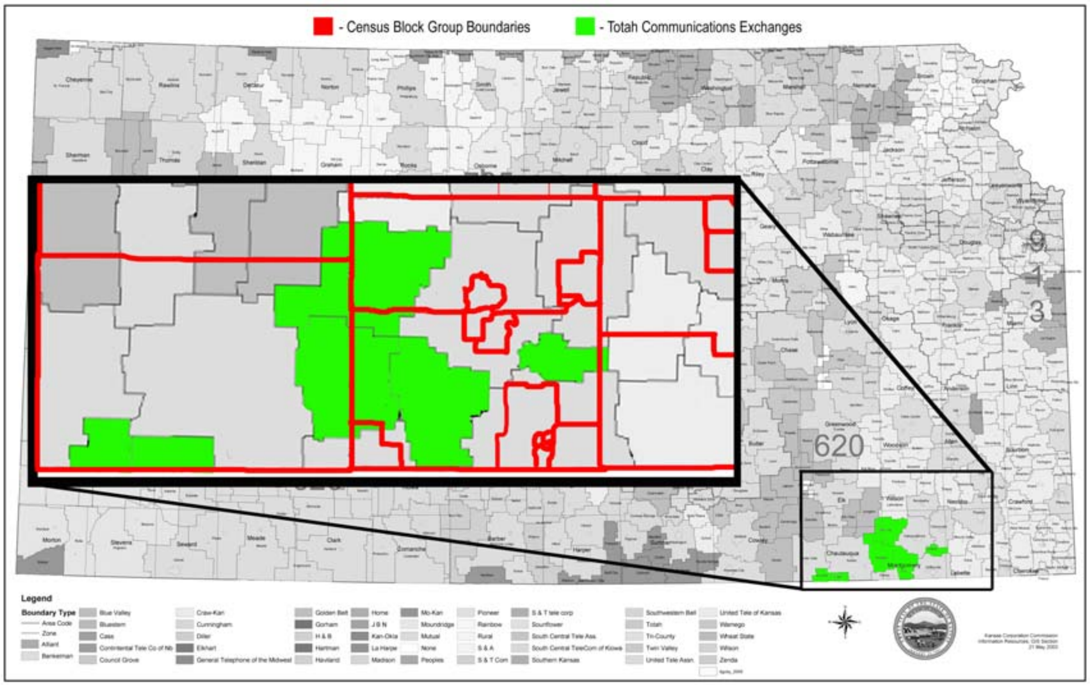
<u>Totah Communications - Oklahoma</u>

- Cellular Market Area 57 Boundaries
- Cellular Market Area 599 Boundaries
- Totah Communications Exchanges

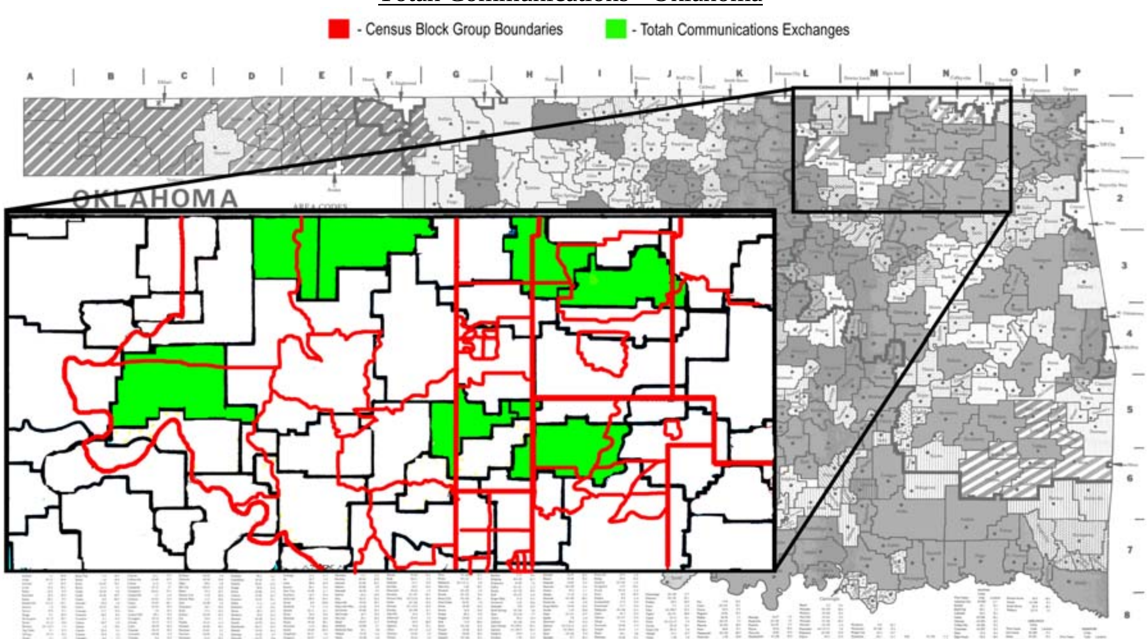


Census Block Groups (CBG) do not match the footprint of rural ILECs and therefore are inappropriate to use as a reverse auction area. As an example, Totah Communications service area is much smaller than several of the CBG areas.

Totah Communications – Kansas



Totah Communications - Oklahoma



* CBG boundaries were sourced from Microsoft Map Point 2006. CBGs do not cross county boundaries.

BRIEF DISCUSSION OF RATE OF RETURN REGULATION

1. What Is Rate Of Return Regulation?

- This form of regulation was designed to allow a rural ILEC to receive sufficient revenues from regulated services to recover its annual expenses and taxes, and to earn a reasonable return on its net investment (total investment for regulated services less depreciated investment).
- Regulated services generally are local exchange and network access services.
- The costs (expenses, taxes and return on net investment) for non-regulated services are not subject to rate of return regulation. These costs are excluded from the rate of return calculations using costing procedures specified by the Commission (Part 64 of the FCC's Rules).

2. Why Is Rate Of Return Regulation Used?

- Rate of Return regulation is essentially a compact or agreement (social contract) between Federal and State regulators and rural ILECs.
- Under this social contract, rural ILECs agree to provide ubiquitous network facilities in low density, high cost to serve areas at just reasonable and affordable rate levels, with basic and advanced services comparable to those offered in urban areas.
- The Commissions (Federal and State), under this social contract, agree to provide the rural ILECs with revenues (from rates and/or support funding) sufficient to cover (a) annual expenses and taxes and (b) an opportunity to earn a sufficient rate of return on the net investment. The rate of return is established by the

regulators and is a proxy for the return that a rural ILEC may earn if its funds were invested in another enterprise.

- This long standing regulatory social contract between rural ILECs and regulators was, and continues to be essential in insuring that telecommunications services are deployed where basic and advanced services would not otherwise be provided because of the high cost to provide and maintain service.
- Without this social contract between regulators and rural ILECs that insures that sufficient revenues are available to earn a reasonable return on costs invested in rural high cost networks, lenders would not provide the massive amount of capital that makes these networks possible.

3. Generally, How does Rate Of Return Regulation Work for Rural ILECs?

- The Commissions (Federal and State) establish rates (including universal service funding) for regulated services at levels that will insure that sufficient revenues are available for rural ILECs to (a) recover its annual expenses and taxes and to (b) provide the opportunity to earn a reasonable return on its net investment.
- State Commissions establish rate levels for local exchange and state access services, and specify the rate of return that a rural ILEC may earn on its intrastate net investment. State costs used in this ratemaking process are determined based on jurisdictional cost allocation procedures specified by the FCC (Part 36 of the FCC's Rules).
- The FCC establishes (a) rate levels for interstate access services and (b) the level of interstate universal service funding, and specifies the rate of return that a rural ILEC may earn on its interstate net investment for both the access services and

universal service funding. Federal costs used in this ratemaking process are determined based on jurisdictional cost allocation procedures specified by the FCC (Part 36 and 54 of the FCC's Rules).

- Rate levels for regulated services are generally determined in proceedings before the Commissions. In these proceedings, all interested parties have the opportunity to comment on the proposed rate levels.
- In the Federal jurisdiction, rural ILECs may file for their own access rate levels or may participate in NECA rate filings. Most rural ILECs participate in NECA access filings because they do not have the resources to file their own rates and because they benefit from the average rate levels for all of the local exchange carriers that participate in the NECA tariff process.
- Federal universal service funding received by a rural ILEC is determined based on its costs (expenses, taxes and authorized return on net investment). Rules for the funding calculation are included in Parts 36 and 54 of the FCC's Rules. Costs are reported annually by each rural ILEC to NECA and USAC and funding revenues to recover the costs are remitted to the local exchange carrier.

4. Is There Sufficient Oversight Of The Rate Of Return Ratemaking Process?

- The following flow chart provides a brief overview of the jurisdictional costing and ratemaking process.
- As shown on the flowchart, every step of the process by which costs are allocated to determine rates or universal service funding is governed by specific FCC rules (Parts 32, 36, 54, 64, 69). Further rules are often specified by State Commissions.

- The flow chart also shows, generally, the review process. Once again, every step of the rate of return costing process that leads to rates and universal service funding for rural ILECs is reviewed and/or audited by regulatory agencies and/or independent organizations such as NECA, USAC and the GAO.